ECONOMICS 3B

FINAL ASSESSMENT
ATTENDANCE FORM

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Venue	

REQUEST: READ THE FOLLOWING GENERAL INSTRUCTIONS AND ADHERE TO EACH ONE OF THEM:

1. **Do not remove the staple.**
2. **Tear off (remove) only the top page (this page), complete requests 1-5.**
3. Check that your paper has **19 numbered pages**.
4. Write your student number **direct after each page number at the left bottom of each page**.
5. WRITE DOWN YOUR SURNAME AND INITIALS. **THIS IS ESSENTIAL** FOR THE SORTING OF PAPERS AND THE CAPTURING OF MARKS.

Sign in full below to confirm your adherence to these 5 requests:

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ATTENDANCE FORM: EKN3B

	ECONOMICS 3B **FINAL ASSESSMENT** **SCHOOL OF ECONOMICS AND ECONOMETRICS**

UNIVERSITY OF JOHANNESBURG

Date	November, 2018
Marks	120
Time	3 hours
Examiners:	Kesaobaka Mmelesi and Christie Schoeman
Internal moderator:	Prof Beatrice Simo-Kengne
External examiner and moderator:	Prof Anmar Pretorius (NWU)

Surname and Initials	

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	Marks	Total
A		15
B1		20
B2		15
B3		20
B4		20
B5		30

GRAND TOTAL	**/120**

Section A – Multiple Choice **[15]**

<u>Complete Section A on the answer sheet on p.6 of the assessment paper.</u>

1. What will the impact in the domestic money market be if the SARB buys foreign currency on the foreign exchange market?

i. A decrease in the currency deposits held by banks.
ii. An increase in rand supply through printing of physical notes and coins.
iii. A decrease in the foreign reserves (balance) held by the SARB.
iv. i and iii.

2. An increase in the buying of bonds denominated in US dollar will result in:

i. Capital outflows from the RSA.
ii. An appreciation in the ZAR/US dollar exchange rate.
iii. A depreciation in the ZAR/US dollar exchange rate.
iv. i and iii.

3. If there is an increase in the demand for ZAR deposits, what will happen to the value of foreign bonds?

i. The return on foreign bonds will increase.
ii. The prices on foreign bonds will increase.
iii. The prices of ZAR denominated bonds will decrease.
iv. i and iii

4. A country with high unemployment and uncertainty, like in South Africa, will prefer a(n):

i. The SARB to increase the repo rate.
ii. Depreciation in the ZAR/dollar exchange rate.
iii. Decrease in expected the return on ZAR denominated bonds.
iv. Overvalued ZAR.

5. A government in a country with a large degree of uncertainty:

i. Will use expansionary fiscal policies to counter structural unemployment.
ii. Will use temporary monetary policy to counter cyclical unemployment.
iii. Will use socio-economic policy to counter unemployment.
iv. Not one of the alternatives above.

6. A mispriced lilangeni (parallel currency of Swaziland) in an uncertain environment will be to the benefit of Swaziland if it is:

i. Relatively undervalued.
ii. Relatively overvalued.
iii. Relatively scarce.
iv. Relatively abundant.

7. If the R/pound spot exchange rate changes from R16.50/pound to R16.25/pound, which of the following statements would be correct?

i. The rand has appreciated.
ii. The exchange rate is expressed according to the direct quotation.
iii. South Africans will need more rand to pay off their foreign debt.
iv. i and ii.

8. What is the rate of return/loss in ZAR on an investment of R4000000 in the USA if the ZAR/$ exchange rate changes from R10/$1 to R12/$1 in the same year?

i. 10 % loss.
ii. 20 % return.
iii. 10 % return.
iv. None of the above.

9. If the rand is currently R10/$ and according to purchasing power parity it should be R12/$, how would one describe the state of the rand?

i. Indirectly quoted
ii. Fixed
iii. Overvalued
iv. Undervalued

10. If you compare the current inflation rate in South Africa and the current inflation rate in the USA, what should have happened to the R/$ exchange rate according to the theory of PPP?

i. The rand should depreciate against the US dollar
ii. The rand should appreciate against the US dollar
iii. The SARB will be forced to devalue the Rand
iv. The SARB will be forced to revalue the Rand

11. What effect will a sudden and unexpected depreciation of a country's currency have on its major macroeconomic indicators?

i. The inflation rate will start to fall
ii. The volume of exports will eventually fall
iii. The unemployment rate will decrease
iv. Imports will become more expensive

12. If the R/$ spot exchange rate changes from R8/$ to R5/$, which of the following statements would be correct?

a. The rand has depreciated
b. The exchange rate is expressed according to the direct quotation
c. South Africans will need more rands to pay off their foreign debt
d. The revenue of gold mines (denominated in rand) will fall

i. a & c
ii. b & d
iii. d
iv. All the statements are correct

13. The difference between the nominal and the real exchange rate of a country is the result of:

i. Domestic price levels of countries
ii. Relative price levels of countries
iii. Relative interest rate levels of countries
iv. ii & iii

14. Which of the following has to be correct for absolute PPP to hold between South Africa and United States of America?

i. Low transportation costs of goods
ii. Real exchange rate must equal 1
ii. Tariffs must be zero in both countries
iv. All of the above

15. The value of currency in relative price basket terms, is known as

i. Real exchange rate
ii. Floating exchange rate
iii. Effective exchange rate
iv. Nominal exchange rate

Section A - Answer Sheet

(Remember to write your student number on the bottom of this sheet as well)

<u>Indicate the correct answer by a cross</u> **<u>which fills the full space of the block.</u>**

	i	**ii**	**iii**	**iv**

Question/Alternative				
1				
2				
3				
4				
5				
6				
7				
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<u>Section B</u>

Section B

Question *B1* **[maximum 20]**

You are an economist working on the bond market. The current spot rate of asset R1 is assumed to be higher than the current long run spot rate (to mature in 2 years) of asset R2. In terms of the term structure of interest rate what will be?

The expectation on the future spot price of R1 under the expectation theory when assumed all agents on the bond market are risk neutral.
Name and explain:

(4)

The expectation on the future spot rate on short run bond under the expectation theory when it is assumed all agents are income risk aversive.
Name and explain:

(4)

The expectation on the future spot price of R1 under the market segmentation theory.
Name and explain:

(4)

The expectation on the future spot price of R1 under the preferred habitat theory.
Name and explain:

(4)

The expectation on the future spot rate on the short run bond under the preferred habitat theory.
Name and explain:

(4)

The expectation on the future spot price of R2 under the expectation theory.
Name and explain:

(4)

Question *B2* **[10]**

Explain <u>*in short*</u>, the *meaning of the* following concepts:

Speculate demand for money.	*Explanation*

(2)

Term structure of interest rate.	*Explanation*

(2)

Endogenously determined money demand.	*Explanation*

(2)

Foreign exchange Swaps.	*Explanation*

(2)

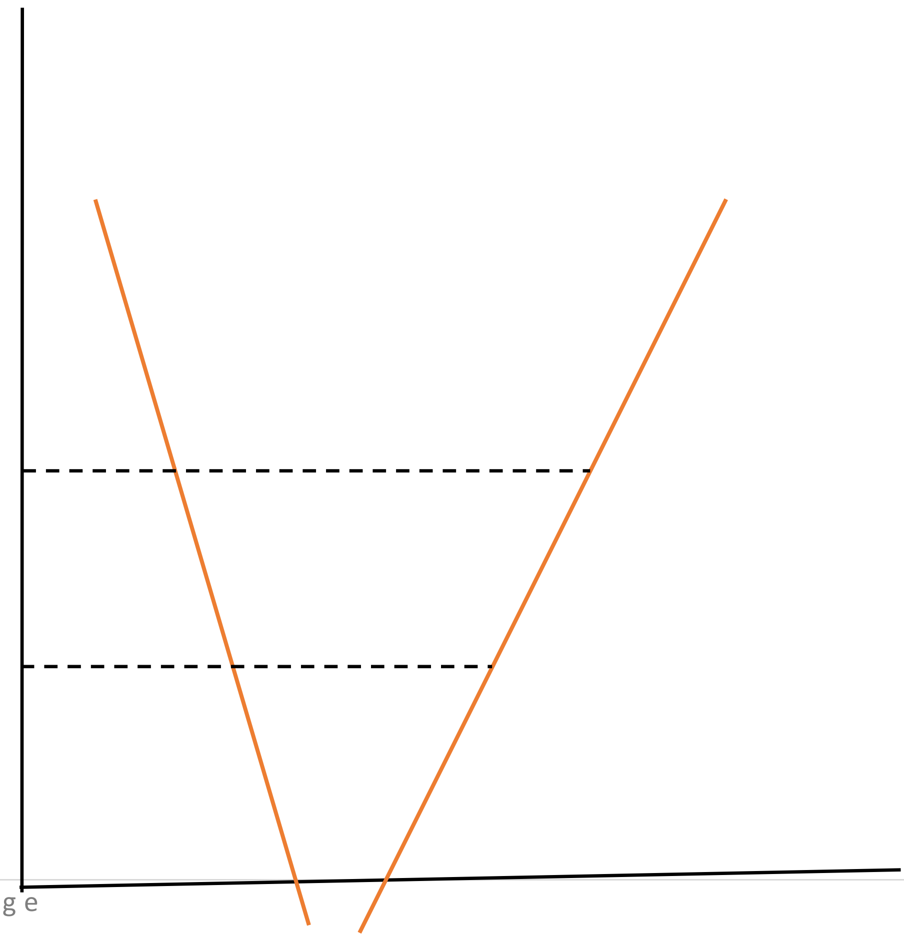
Liquidity.	*Explanation*

(2)

Question *B3* ***[maximum 20]***

Complete the following graph to reflect:

- *Real Savings*
- *Real investment*
- *Real Return*
- *Real Quantity saved*
- *Real Quantity invest*



(6)

Name and explain the reason why real Investment and real Savings do not meet at a positive rate of return on the graph.
Name and explain:

(4)

Study the graph above and consider the proposed action of the SARB to answer the following questions:

Assume the SARB has increased the rate on repurchasing agreements with banks.
The impact such an action by the SARB will have on South African

<u>Impact</u>	***<u>Explanation</u>***
- **Employment**	
- **Investment**	
- **Production**	

- **Savings**	

(12)

Question *B4* **[maximum 20]**

Demonstrate by use of a graph equilibrium in the foreign exchange market in South Africa if interest rate parity (theory) holds. Assume a long run equilibrium exchange rate of R14 =1 US$, a current spot of R12=1 US$ and return on ZAR deposits of 10%. (5)

<u>Graph</u>

Make use diagram to identify the impact and/or explain the following:

A decrease in the quantity of money deposits demanded in South Africa on the spot exchange rate.

The impact and the reason for such an impact:

(3)

Why would such a disequilibrium in exchange rate be only of a temporary nature?
Explantion:

(3)

An increase (shift) in the interest rate on money deposits in SA on the expected return on foreign assets.
The impact and the reason for such an impact:

(3)

A expected depreciation in the long run equilibrium exchange rate.
The impact and the reason for such an impact:

(3)

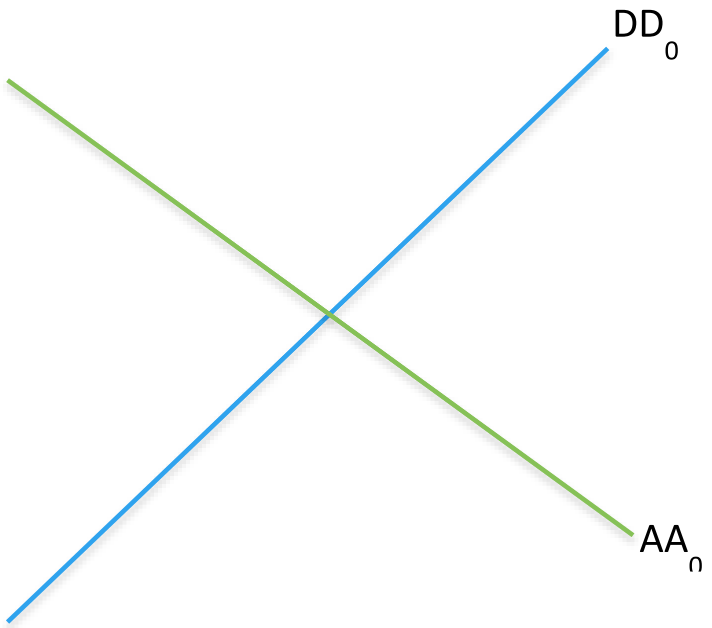
An decrease (shift) in the demand for money deposits in the USA.
The impact and the reason for such an impact:

(3)

Question *B 5* **[maximum 30]**

Inspect and complete the graph below representing the RSA and answer the questions which follows. Assume an expected long run exchange rate equilibrium of R14 = 1 US dollar at $\boldsymbol{Y_1}$ or full employment production. **(5)**

Graph



ii) Make use of the diagram above and explain the impact of:

An increase in the expected return of money deposits in the USA on the: (i) Short run exchange rate in the RSA. (ii) Short run employment rate in the RSA.

The impact and the reason for such an impact:

(5)

An increase in the price of goods and services in the USA on the : (i) Long run exchange rate denominated in ZAR *(ii)* Long run production in the RSA.
The impact and the reason for such an impact:

(5)

A decrease in the supply of bonds by the Federal Reserve Bank on the: (i) Long run exchange rate denominated in the ZAR (ii) Long run employment in the ZAR.

The impact and the reason for such an impact:

(5)

A temporary decrease in political and social risk in SA on the: (i) Short run exchange rate denominated in the ZAR (ii) Short run production in the RSA.
The impact and the reason for such an impact:

(5)

An ongoing (permanent) increase in the political and social risk in SA on the (i) Expected long run exchange rate denominated in the ZAR and (ii) Long run production in the RSA.

(5)

THE END

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